# STATE OF ALABAMA DEPARTMENT OF INSURANCE MONTGOMERY, ALABAMA

#### REPORT OF

#### ASSOCIATION EXAMINATION

OF

# MUTUAL SAVINGS FIRE INSURANCE COMPANY

DECATUR, ALABAMA

AS OF

**DECEMBER 31, 2004** 

PARTICIPATION:

SOUTHEASTERN ZONE: ALABAMA

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#### STATE OF ALABAMA

#### **COUNTY OF MORGAN**

Anne L. Ward, being first duly sworn, upon her oath deposes and says:

THAT she is an examiner appointed by the Commissioner of Insurance for the State of Alabama;

THAT an examination was made of the affairs and financial condition of MUTUAL SAVINGS FIRE INSURANCE COMPANY, Decatur, Alabama, for the period of January 1, 2001 through December 31, 2004;

THAT the following 46 pages constitute the report thereon to the Commissioner of Insurance of the State of Alabama;

AND THAT the statements, exhibits and data therein contained are true and correct to the best of her knowledge and belief.

Anne L. Ward, AFE (Examiner-in-Charge)

Subscribed and sworn to before the undersigned authority this 17th day of March 2006.

Suson Blackwood
(Signature of Notary Public)

Susan Blackwood Notary Public (Print Name)

in and for the State of Alabama

My Commission expires

SUSAN C. BLACKWOOD
Notary Public, AL State at Large
My Comm. Expires Dec. 06, 2009



BOB RILEY GOVERNOR

#### STATE OF ALABAMA

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PRODUCER LICENSING MANAGER
JIMMY W. GUNN

March 17., 2006

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Secretary, Southeastern Zone Honorable Walter A. Bell Commissioner of Insurance State of Alabama Department of Insurance 201 Monroe Street, Suite 1700 Montgomery, AL 36104

#### Dear Commissioners:

Pursuant to your authorization and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a full scope financial and market conduct examination as of December 31, 2004, has been made of the affairs and financial condition of

#### MUTUAL SAVINGS FIRE INSURANCE COMPANY

at its home office located at 2801 Highway 31 South, Decatur, Alabama 35603. The report of examination is submitted herewith.

Where the description "Company" or "MSFire" appears herein, without qualification, it will be understood to indicate *Mutual Savings Fire Insurance Company*.

#### SCOPE OF EXAMINATION

The Company was last examined for the four-year period ended December 31, 2000, by examiners from Alabama representing the National Association of Insurance Commissioner's (NAIC) Southeastern Zone. The current examination covers the intervening period from the date of the last examination through December 31, 2004, and was conducted by examiners from Alabama representing the NAIC's Southeastern Zone. The examination was conducted concurrently with the examination of the Company's parent, Mutual Savings Life Insurance Company (MSLIC), Decatur, Alabama.

The examination was made in accordance with the statutory requirements of the *Alabama Insurance Code* and the Alabama Department of Insurance's (ALDOI) regulations and bulletins; in accordance with the applicable guidelines and procedures promulgated by the NAIC; and in accordance with generally accepted examination standards and practices in connection with the verification of assets and determination of liabilities.

The examination included an inspection of corporate records, test checks of recorded income and disbursement items for selected periods, a general review of records and files pertaining to operations, administrative practices, and compliance with statutes and regulations. Assets were verified and valued and all known liabilities were established or estimated as of December 31, 2004, as shown in the financial statements contained herein. However, the discussion of specific assets or liabilities contained in this report is confined to those items where a change was made by the examiners, or which indicated violation of the *Alabama Insurance Code* and the ALDOI's rules and regulations or other insurance laws or rules, or which were deemed by the examiners to require comments or recommendations.

A Company office copy of the filed Annual Statement for the year 2004 was compared with or reconciled to account balances with respect to ledger items.

The market conduct review consisted of a review of the Company's territory; plan of operation; complaint handling; marketing and sales; compliance to agent's licensing requirements; policyholder services; underwriting and rating practices; claim payment practices; and privacy policy and practices.

The Company's accounts were audited by Deloitte & Touche, LLP, Certified Public Accountants (CPAs), for each of the four years under examination. Audit reports and workpapers were made available to the examiners and were used where deemed appropriate in the completion of this examination.

A signed certificate of representation was obtained during the course of the examination. In this certificate, management attested to having valid title to all assets and to the non-existence of unrecorded liabilities as of December 31, 2004.

#### ORGANIZATION AND HISTORY

The Company was incorporated in Decatur, Alabama, on September 16, 1971, under the laws of the State of Alabama and commenced business on January 2, 1973. The Certificate of Incorporation stated that the objects and purposes of the corporation were "to engage in, maintain and transact a general fire and casualty insurance business, and to do all things necessary and incidental thereto." The Articles of Incorporation were filed and recorded in the office of the Judge of Probate of Morgan County, Alabama.

The original charter provided that the total authorized capitol was 1,000,000 shares of common stock with a par value of \$1 per share. The Company was capitalized initially with \$200,000 of paid-up capital and \$300,000 of contributed surplus. On July 15, 1975, the Company increased its paid-up capital to \$500,000, and its contributed surplus to \$500,000, through the sale of additional shares of common stock. The Company increased its common stock par value to \$3 per share on December 18, 1992, thereby increasing its paid-up capital to \$1,500,000.

The Company's authorized capital has not changed during the four-year period covered by this examination. At the December 31, 2004 examination date, the Company's Annual Statement reflected outstanding capital stock totaling \$1,500,000, consisting of 500,000 shares of \$3 par value *Common stock* and \$485,530 in *Unassigned funds (surplus)*.

On December 4, 1998, Primesco, Inc., a Delaware corporation, acquired 100% of the outstanding common stock of Mutual Savings Life Insurance Company (MSLIC), the sole stockholder of the Company. As of December 31, 2004, the Company was a wholly-owned subsidiary of MSLIC.

#### MANAGEMENT AND CONTROL

The By-Laws, as amended, provide that the business and affairs of the Company be managed by its Board of Directors, which will consist of not less than three directors. The directors are elected at the annual meeting of the Stockholder to serve until the next annual meeting or until their successors are duly elected and qualified. Officers of the Company are elected by the newly elected Board of Directors, at a meeting held immediately after the annual meeting of the Stockholder.

#### **Stockholders**

The Company is a wholly-owned subsidiary of Mutual Savings Life Insurance Company, which is a wholly-owned subsidiary of Primesco, Inc., a Delaware corporation.

#### **Board of Directors**

Members elected to the Board of Directors by the stockholder and serving at December 31, 2004 were as follows:

<u>Director/Address</u>	Principal Occupation
Charles Larimore Whitaker	Chairman, President, CEO
Birmingham, Alabama	Mutual Savings Life Insurance Company
Walter Jones Hughes	Executive Vice President, COO
Birmingham, Alabama	Mutual Savings Life Insurance Company
Don Francis Morrison	Secretary, Senior Vice President
Decatur, Alabama	Mutual Savings Life Insurance Company

#### **Officers**

The following officers were elected or re-elected to their respective positions on December 28, 2004:

<u>Officer</u>	<u>Title</u>
Charles Larimore Whitaker	Chairman of the Board, President and Chief Executive Officer
Walter Jones Hughes	Executive Vice President, Chief Operating Officer and Assistant Secretary
Ronald John Koch	Senior Vice President, Treasurer and Chief Financial Officer
Glenn Alan Lansdell	Senior Vice President, General Counsel and Assistant Secretary
Don Francis Morrison	Senior Vice President and Secretary

George Arthur Armour Larry Joe Burton Woodie Lee Melton Bobby Jefferson Outlaw Susan Adams Burns Joseph Calvin Chapman Robert Elerby Colburn Judy Oakley Hagen Kenneth O'Neal Jordan Bruce Howard Lea James Richard Lown Joe Michael Moore Stephen Richard O'Shea Clark Larimore Whitaker Murry Joe Woodard Roderick LaBron Davis Frankie Drinnen Graves Deborah Marie Holmes Brenda Ballew McMinemon Roger Don Schaffer Wanda Downs Smith James Harlan Wallace Mary Sandusky White Thomas Russell White Sandra Vest Roden

Regional Vice President Regional Vice President Regional Vice President Regional Vice President Vice President and Assistant Treasurer Vice President Assistant Vice President

#### Committees

The Company has no committees of the Board of Directors.

#### Conflicts of Interest

The Company adopted a conflict of interest policy in 1984, and requires a conflict of interest statement be completed annually by all directors and officers. The purpose of the statement is to disclose conflicts between the Company's interest and the interest of its directors and officers. A review of the statements signed during the examination period indicated that no material conflicts had been reported.

Assistant Secretary

#### **CORPORATE RECORDS**

The Articles of Incorporation and By-Laws and amendments thereto were inspected during the course of the examination and appeared to provide for the operation of the Company in accordance with usual corporate practice and applicable statutes and regulations. There were no amendments during the four-year examination period.

Minutes of meetings of the stockholder and Board of Directors were reviewed for the period under examination. The minutes appeared to be complete with regard to actions taken on matters before the respective bodies for deliberation and action, except as noted otherwise in this report.

It was again noted that the Company's Board of Directors did not approve investments as required by ALA. CODE § 27-41-5 (1975), which specifies that all investments be authorized, approved, or ratified by the Board of Directors and that the Board's actions be recorded on a regular basis. The previous examination report recommended that the Company approve its investments in accordance with the aforementioned section of the *Alabama Insurance Code*. Non-compliance with this recommendation is noted in the COMPLIANCE WITH PREVIOUS RECOMMENDATIONS section of this examination report, under the "Corporate Records" caption.

Subsequent to the examination period, on December 22, 2005, the Board of Directors ratified and approved the Company's investment portfolio and all investment transactions implemented/effected by or as a result of the Investment Advisory Agreement under which it had been operating.

# HOLDING COMPANY AND AFFILIATE MATTERS

#### Holding Company Registration

The Company is deemed to be subject to the Alabama Insurance Holding Company System Regulatory Act as defined in ALA. CODE § 27-29-1 (1975). In connection therewith, the Company's parent, Mutual Saving Life Insurance Company, is registered with the Alabama Department of Insurance on the Company's behalf, as a registrant of an insurance holding company system.

Appropriate filings required under the Holding Company Act are made from time to time by the Company, as joint registrant of an Insurance Holding Company System. A review of the Company's filings during the period under examination indicated that all required disclosures were included in the Company's filings.

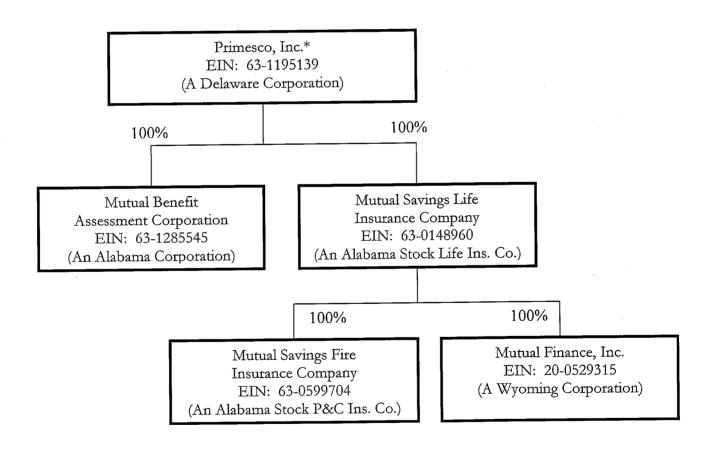
#### Dividends to Stockholders

The Company paid the following dividends during the period covered by this examination:

<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
\$400,000	\$338,000	\$100,000	\$-0-

#### Organizational Chart

The following chart presents the identities of and interrelationships among all affiliated persons within the Insurance Holding Company system at December 31, 2004:



<sup>\*</sup>Primesco, Inc. shareholders with greater than 10% (assuming exercise of all options) are: C. Larimore Whitaker 14.47% (32.12% including relatives and family) and separate affiliates of J.O. Hambro Capital Management (through various funds and nominees) own 25.21%.

### Transactions and Agreements with Affiliates

#### Tax Allocation Agreement

On September 28, 2004, an Agreement to Allocate Consolidated Federal Income Tax was entered into by Primesco, Inc., and its affiliates: Mutual Savings Life Insurance Company, Mutual Savings Fire Insurance Company, Mutual Benefit Assessment Corporation and Mutual Finance, Inc. This agreement states that federal income taxes owed by the companies, as a group shall be allocated to each company in the direct proportion that the taxable income of each company bears to the total taxable income of all the companies.

The agreement was approved by the Alabama Insurance Commissioner on November 8, 2004, in accordance with the requirements of ALA. CODE § 27-29-5 (1975) and SSAP No. 10, of the NAIC's Accounting Practices and Procedures Manual.

<u>Management and Services Agreement between Mutual Savings Life Insurance Company</u> and <u>Mutual Savings Fire Insurance Company</u>

A Management Services Agreement was made and entered into on October 21, 2002, by and between Mutual Savings Life Insurance Company (MSLIC) and the Company. This is a revised agreement that was originally entered into on January 2, 1974. The previous examination report recommended that the agreement be updated and submitted to the Alabama Department of Insurance for approval.

Under the terms of this agreement, MSLIC agrees to be a representative of the Company for marketing, underwriting and servicing of its business. All employees and licensed field personnel were provided by and were employees of MSLIC. The Company agreed to pay all expenses that could be identified as its direct expenses and for services necessary for the proper operation and administration of the Company.

On December 17, 2002, the Commissioner granted approval to the revised version of the agreement with the understanding that any changes to the reimbursement rate established in Section 5 constitute a material change in the agreement and as such, requires a Form D filing in compliance with ALA. CODE § 27-29-5 (1975).

MSLIC collects premiums for the Company under this management and services agreement between the two companies. The Company's premiums are being deposited into a MSLIC bank account. MSLIC writes a check to the Company monthly for premiums collected throughout the month. ALA. CODE § 27-27-26 (1975) states, in pertinent part, that "any employee of a domestic insurer who is charged with the duty

of...handling the insurer's funds shall not deposit...such funds except in the insurer's corporate name." The agreement stipulates:

- "2. Mutual Life agrees to provide Mutual Fire with competent, trained and licensed field personnel ("Agents") for the sale to the public of fire insurance policies and the servicing of such policies, including the collection of periodic insurance premiums, as may be issued by Mutual Fire. In performing such services, it is understood and agreed that all Agents shall be employees of Mutual Life and not employees of Mutual Fire.
- 3. Mutual Life agrees to remit, within thirty (30) days of the end of each month, all premiums collected by its Agents on such fire insurance policies to Mutual Fire."

As noted above, this *Management Services Agreement* was approved by the Alabama Department of Insurance on December 17, 2002.

Management and Services Agreement between Primesco, Inc., Mutual Savings Life Insurance Company and Mutual Savings Fire Insurance Company

A Management Services Agreement was made and entered into on October 19, 1999, by and between Primesco, Inc. (Primesco), a Delaware corporation; Mutual Savings Life Insurance Company (MSLIC); and Mutual Savings Fire Insurance Company. This agreement was submitted to the Alabama Department of Insurance for approval.

The Service Company (Primesco) entered into agreements with or has engaged consultants who specialize in the following:

- Processing and settlement of claims;
- Litigation practices and strategies;
- Supervision of agents and sales representatives;
- Rendering investment advice;
- Seeking out suitable acquisitions;
- Assisting with financing of acquisitions; and
- Financing the general operations.

The Department reviewed the documentation submitted by the Company. The invoices contained language stating that Primesco may rescind or modify any amounts due at its option and that any such amounts due must be remitted within two days of such modification. The review of the Agreement did not support that statement. Section 3 did permit Primesco to waive amounts due but does not permit the modifying or rescinding of any waivers granted. As a result, on December 12, 2002, the Department issued a final approval with the understanding that Primesco is not permitted to rescind

or modify any waivers granted under the contract and that MSLIC must account for any amounts waived as contributed surplus.

# FIDELITY BOND AND OTHER INSURANCE

#### Fidelity Coverage

During the examination period, the Company did not carry fidelity bond coverage for protection against dishonest or fraudulent acts committed by employees. The previous two examinations have recommended that the Company obtain at least minimum coverage. Management's response to the fidelity bond recommendation was that:

"Mutual Savings has made the business decision that, given the large number of agents and managers it employs, the purchase of a fidelity bond (or similar coverage), would not be cost effective and that it would be better for Mutual Savings to self insurer against such risk. Management has taken the examination recommendation under advisement and may secure future quotes to determine if its policy of self insuring is still cost effective."

"Management firmly believes this is truly a management decision based on cost versus benefits. Based on verbal premium quotes to provide this coverage, which the company has received in the past, management does not believe this coverage is economically worth the cost for the coverage which would be provided. We do not deny that this decision contains some risk, but in the almost 78 years MSLIC has been in business, it has not had any fidelity coverage of this magnitude and there are significantly larger risks such as litigation risks that are not insured."

A senior vice president stated that the Company has not established self insurance reserves as "a liability has not been incurred as of the date of the financial statement." Management also indicated that the Company "…has tried to obtain quotes and has been turned down for this type of coverage, due to the number of agents and district locations making collections."

According to the NAIC's <u>Financial Condition Examiners Handbook</u>, the minimum amount of suggested coverage should be between \$100,000 and \$125,000.

#### Other Insurance

At December 31, 2004, the Company maintained the following coverages:

- fiduciary liability;
- workers' compensation and employers' liability;
- directors and officers liability; and

commercial umbrella liability.

The coverages and limits carried by the Company were reviewed during the course of the examination and appeared to adequately protect the Company's interests.

#### EMPLOYEE AND AGENTS WELFARE

All personnel were employees of Mutual Savings Life Insurance Company, which provided services to the Company under the terms of the *Management Services Agreement*. This agreement is discussed in detail in the HOLDING COMPANY AND AFFILATE MATTERS section of this report under the "Transactions and Agreements with Affiliates" caption.

### Compliance with ALA. ADMIN. CODE 482-1-121 (2003)

All personnel were employees of Mutual Savings Life Insurance Company (MSLIC), which provided services to the Company under the terms of the aforementioned *Management Services Agreement*.

The Company is required to comply with the Violent Crime Control and Law Enforcement Act of 1994, US Code, Title 18, Section 1033 (e)(1) (A), and ALA. ADMIN. CODE 482-1-121 (2003), Procedures Governing Persons Subject to 18 U.S. Code § 1033, which, in part, prohibit individuals who have been convicted of specified criminal activity from engaging in the business of insurance without written consent from the Commissioner of Insurance. MSLIC performs background checks on all prospective employees to ensure compliance with this act and requires the completion of Pre-Hire Authorization of Consumer Investigative form for any prospective employee. A questionnaire is submitted to the prospective employee, which asks if he or she has been convicted of a crime. However, at the examination date, neither company had a formal policy for monitoring current employees to ensure that they are in compliance. ALA. ADMIN. CODE 482-1-121 (2003), Guideline 1, states that: "Failure to initiate a screening process in an attempt to identify prohibited persons in current or prospective employment relationships may be a factor in determining if a violation of this statue has occurred."

In order to qualify for annual license renewal, the Company's field force is required to complete a question on the Alabama Department of Insurance's *Producer License Renewal Form*, which asks "Have you <u>EVER</u> been charged with or convicted of a felony or misdemeanor?" Effective January 1, 2006, management implanted a program to obtain similar certification from its home office employees.

#### SPECIAL DEPOSITS

In order to comply with the statutory requirements for doing business in the various jurisdictions in which it was licensed, the Company had the following securities on deposit with state authorities at the December 31, 2004 examination date:

<u>State</u>	Par <u>Value</u>	Statement <u>Value</u>	Fair <u>Value</u>
Alabama	\$ <u>125,000</u>	\$ <u>128,966</u>	\$ <u>131,061</u>
Georgia	\$ <u>100,000</u>	\$ <u>100,000</u>	\$ <u>100,000</u>
Louisiana	\$ <u>20,000</u>	\$ <u>20,000</u>	\$ 20,000
Totals	\$ <u>245,000</u>	\$ <u>248,966</u>	\$ <u>251,061</u>

Confirmation of these deposits was obtained directly from the respective custodians.

# FINANCIAL CONDITION/GROWTH OF THE COMPANY

The following table sets forth the significant items indicating the growth and financial condition of the Company for the period under review:

	Admitted			Premiums
	<u>Assets</u>	<b>Liabilities</b>	<u>Surplus</u>	<b>Earned</b>
2004*	\$ 3,166,613	\$ 1,374,083	\$ 1,792,530	\$ 4,135,392
2003	 4,023,795	632,336	3,391,459	4,281,613
2002	4,058,459	601,270	3,457,189	4,294,188
2001	3,964,036	575,756	3,388,280	4,160,546
2000*	4,196,261	1,179,116	3,017,145	4,318,698

<sup>\*</sup> Amounts for the years 2000 and 2004 are per examination. Data for the remaining years were obtained from the Company copies of filed Annual Statements.

#### MARKET CONDUCT ACTIVITIES

#### **Territory**

As of December 31, 2004, the Company was licensed to transact business in the following states:

While currently licensed in four states, the Company primarily writes in the States of Alabama, Mississippi and Georgia. Current or continuous certificates of authority issued by the respective states were inspected for the four-year period under review, and found to be in order.

There were no pending applications at December 31, 2004, and Company management indicated that there were no plans at this time for entry into other states.

#### Plan of Operation

MSFire is wholly-owned by Mutual Savings Life Insurance Company (MSLIC), a subsidiary of Primesco, Inc. The Company's policies are sold and serviced by captive agents of the parent company. At the examination date, MSLIC's sales organization consisted of an agency and service field force, which was responsible for the marketing and servicing of its various lines of insurance products. The insurance products are offered to low-to-middle income households through a home service approach. The agents are assigned territories called "Agencies" where they conduct consultations in homes to sell insurance and collect premiums. This method of marketing requires face-to-face contact.

The field force is divided into districts. Each district consists of agents, managers and support personnel. All are employees of MSLIC. The district managers are under the supervision of regional vice presidents. At December 31, 2004, business was produced by approximately 427 captive agents.

The field management and agents are compensated by a service commission based on the following factors: agency size and sales commission, newly produced business and retention. The sales commission varies according to the type of policy written.

The Company writes a limited amount of Industrial Fire and Contents coverage (\$20,000 dwelling and \$10,000 contents) on low-valued dwellings in the states of Alabama, Mississippi and to a lesser extent, Georgia. The Company also participates, to a minor degree, in involuntary property pools in each state where it writes business.

#### Marketing and Sales

The Company's Marketing Department consists of four Vice Presidents that report to the Marketing Director. Each Vice President is in charge of a specific area of marketing.

The Vice President of Agency is primarily responsible for all materials that are provided to the agency force on behalf of the Company.

The Company did not have a formal advertising program as of December 31, 2004. During the examination period, the Company's advertising was limited to a printed sales brochure provided to its agency force and a web site website that is accessible by the public. Both were descriptive and indicated the dwelling and contents coverage for fire and allied lines coverage. A review of the provided advertising materials found them to be factual without false, deceptive or misleading statements.

The Company's producer training materials consisted of a training manual, a series of videos and a brochure. The review of these items determined that the producer training materials did not promote any unfair discrimination practices or reference any attempts to avoid statutory compliance.

# Electronic communications between Company and producer

During the examination period, communications between the producers and the Company consisted primarily of bulletins and memorandums. The Company periodically uses an internal mail system to communicate with its agency force. While the system is mainframe driven, the Company does not save, store or archive any of those electronic-mail communications. ALA. CODE § 27-27-29(a) (1975) states the following:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

Management stated that email communications are more similar to informal telephone communications than formal bulletins and memorandums. The Company also indicated that significant communications regarding changes in Company policies, procedures and underwriting guidelines are formally communicated to field personnel in writing, most typically in the Agency Procedure Bulletins and Office Managers Guide. However, the Company could not provide any electronic mail that was broadcast to its sales force.

The examiners were unable to determine if the Company's communications to producers were in accordance with MARKETING & SALES Standard 3, of the NAIC's <u>Market Conduct Examiners Handbook</u> due to the fact that the Company does not save electronic communications to its producers. The Company should develop a policy in order to archive or store communications with its producers.

#### Compliance with Agents' Licensing Requirements

An inspection of Company records was conducted by the examiners to determine that producers representing the Company in Alabama were appropriately licensed and appointed. A register of licensed agents was obtained from the Agents' Licensing Division of the Alabama Department of Insurance (ALDOI) and compared to a current listing provided by the Company.

At December 31, 2004, the Company used captive producers and agencies to sell its products. Only appointed and licensed producers were used to sell its policies in the Southeastern United States where the Company was licensed to conduct business. The total number of producers the Company appointed at December 31, 2004 was 427.

A review of Company records was made by the examiners to determine that producers representing the Company in Alabama were appropriately appointed. A sample of commission payments was reviewed. All items sampled indicated that commission payments were appropriately made to licensed and appointed agents.

Individual terminated producer files were examined to determine if the Company maintains the reason of termination. Selected producer's files contained documentation of the reason of termination and the notices that were mailed the ALDOI in accordance with ALA. ADMIN. CODE 482-1-109.05(2) (2002), which requires insurers to submit a notice of termination for all producer and service representative appointments.

#### **Underwriting and Rating Practices**

The Company's lines of business include fire and allied lines of insurance, writing a limited amount of Industrial Fire and Contents coverage (\$20,000 dwelling and \$10,000 contents) on low-valued dwellings in the states of Alabama, Mississippi and to a lesser extent, Georgia. The Company also participates, to a minor degree, in involuntary property pools in each state where it writes business.

The Company's direct business is sold and serviced by Mutual Savings Life Insurance Company's producers and managers who are licensed to write business for the Company.

A sample of 50 declined policies was selected in order to determine whether the Company documented specific and accurate reasons for adverse underwriting decisions. It was noted that only 78% of the policies sampled included a specific and accurate reason for the declination. The Company sends a standard declination letter that does not include the reason for declination, unless added by the appropriate personnel. The standard letter that the Company sends does not include or indicate that the proposed

insured could request in writing the specific reason for declination. The Company was not in compliance with ALA. CODE § 27-27-29(a) (1975), which states the following:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

A sample of 50 denied applicants for insurance was selected in order to determine if the reason for cancellation/non-renewal was valid according to policy provisions and state law. The review indicated that the Company did not record the reason for the cancellation/non-renewal for two of fifty applicants. The files did not contain complete information; therefore, the Company was not in compliance with the aforementioned ALA. CODE § 27-27-29(a) (1975).

# Treatment of Policyholders and Other Claimants

#### Complaint Handling Practices

Complaints recorded by the Consumer Division of the Alabama Department of Insurance (ALDOI) were compared with the Company's complaint register for the period between January 1, 2001 and December 31, 2004. Thirty-one complaints were recorded by the ALDOI and submitted to the Company for handling. The Company recorded complaints that were reported to various states' departments of insurance and those reported directly to the Company.

A review of the complaint registers indicated that 31 complaints were reported to the ALDOI during the four-year examination period, but the Company provided only four of 31 files. Twenty-one of these complaints were reported to the ALDOI in 2004. All were written grievances as defined by the standards in the NAIC's Market Conduct Examiners Handbook. Company management indicated that two were complaints and the remainder were inquiries; however, no documentation was available for review to corroborate that information. The Company is recording complaints in the correct format; however, the Company is not recording all complaints and is not maintaining complete documentation as required by ALA. CODE § 27-27-29(a) (1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

In addition, COMPLAINT HANDLING Standard 1, of the NAIC's <u>Market Conduct Examiners Handbook</u> requires that "All complaints are recorded in the required format on the company complaint register."

The Company did not have sufficient procedures in place for the satisfactory handling of complaints received, as well as internal procedures for analysis in areas developing complaints due to the fact that three different sets of conflicting procedures were provided by the Company. Management apologized for the appearance that there were conflicting sets of complaint procedures and indicated that two sets of procedures were sequential, not concurrent. COMPLAINT HANDLING Standard 2, of the NAIC's Market Conduct Examiners Handbook, advocates that the Company have "adequate complaint handling procedures in place and communicate such procedures to policyholders."

#### Policyholder Service

One hundred policies were reviewed in order to evaluate the Company's treatment of its policyholders. In the sample reviewed, the Company did not keep a record of all correspondence between the Company and the insured, and did not maintain a record of the insured requested cancellations; therefore, the Company was not in compliance with ALA. CODE § 27-27-29(a) (1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

The examiners were unable to determine if insured-requested cancellations are handled in a timely manner without excessive paperwork requirements because the Company did not have adequate records to review. In addition, the examiners could not determine if all correspondence directed to the Company was answered in a timely manner by the appropriate department. POLICYHOLDER SERVICE Standard 3 of the NAIC's Market Conduct Examiner Handbook, requires that "All correspondence directed to the company is answered in a timely and responsive manner by the appropriate department."

#### Claims Handling Practices

Samples of paid, open, closed, and closed-without-payment claims files were reviewed in order to evaluate the Company's compliance with policy provisions, timeliness of payment, adequacy of documentation, and reserving. The following problems were noted concerning the review of sampled items:

Reservation of Rights/Excess of Loss Letters

The examiners reviewed the Company's claims procedures and determined that the Company does not have guidelines in place for the use of a reservation of rights letter or a notice of excess of loss letter. CLAIMS Standard 7, of the NAIC's Market Conduct Examiners Handbook states: "Company uses the reservation of rights and excess of loss letters, when appropriate." Claims where the Company has reason to question coverage should have a reservation of rights letter sent to the insured. For claims where it is apparent that the amount of loss will exceed policy limits, an excess of loss letter should have been sent to the insured.

Subrogated Claims

The Company does not electronically record that a claim involved subrogation. Company management indicated that while subrogation was theoretically possible, it is a very rare occurrence, and the Company does not pursue subrogation claims in the usual course of business. The Company could not provide any documentation as to whether or not there were any subrogated claims during the examination period. The examiners were unable to determine if the Company refunds deductibles from subrogated proceeds because there were no records of subrogated claims. ALA. CODE § 27-27-29(a) (1975) states that:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

Denied and Closed-without-payment Claims

The Company did not keep manual hard files or electronic copies of the claims that were denied and/or closed-without-payment. Unless a claim is paid, no electronic record is made for that policy. The claims department does not maintain any type of manual file of denied claims. Company management stated that it would not be possible to compile such a listing retrospectively, and as a result, the Company was unable to produce a listing in response to the examiner's request. As noted previously, ALA. CODE § 27-27-29(a) (1975) requires the Company to have and maintain "complete records of its assets, transactions and affairs."

In addition, ALA. ADMIN. CODE 482-1-125-.04(a) (2003) requires that the Company "maintain claim files that are accessible and retrievable for examination...for all claims closed without payment. This data must be available for all open and closed files for the current year and the five (5) preceding years, in order to permit reconstruction of the insurer's activities relative to each claim."

Privacy Policies and Practices

[Compliance with Ala. Admin. Code 482-1-122 (2002) PRIVACY OF NONPUBLIC PERSONAL FINANCIAL INFORMATION – formerly know as Alabama Department of Insurance Regulation No. 122.]

This Regulation governs the treatment of nonpublic personal financial information about individuals by all licensees of the Alabama Department of Insurance and requires a licensee to provide notice to individuals about its privacy policies and practices; describes the conditions under which a licensee may disclose nonpublic personal financial information about individuals to affiliates and nonaffiliated third parties; and provides methods for individuals to prevent a licensee from disclosing that information.

The Company's Notice of Privacy Practices was reviewed for compliance with ALA. ADMIN. CODE 482-1-122 (2002). The notice was first sent out as a mass mailing to all policyholders in 2001. The Company sends the notice to new business policyholders and annually thereafter. The Company provided notices to its customers that indicated the types of information collected, the way it is to be used and the manner of collection. The notice also informed the customer that the Company "may" disclose information to affiliated and nonaffiliated third parties.

The privacy form contained a *Privacy Notice*, which emphasized and explained the Company's policies. These principles appeared to follow the guidelines established in ALA. ADMIN. CODE 482-1-122-.07 (2002), which details information to be included in privacy notices.

The Company does not share customer and/or consumer personal information with any nonaffiliated third parties except those permitted under Sections .14, .15 and .16 of ALA. ADMIN. CODE 482-1-122 (2002), which define exceptions to limits on disclosures. Access to nonpublic personal information is restricted when the insured chooses to opt out. The Company had controls and guidelines in place for its employees and producers on how to handle consumer nonpublic personal financial, health or medical information in accordance with the aforementioned regulation.

#### **REINSURANCE**

#### Reinsurance Assumed

The Company is a party to certain state mandatory risk pool associations, which are accounted for as premiums, losses and loss adjustment expense assumed. Typically, a company's participation is calculated by the pool as a percentage of written or earned premiums to the total of all premium written or earned in the state. Participation

percentages and quarterly or annual reports are obtained by accessing the association's website. The Company is a participant in the following mandatory state risk pools:

- Alabama Underwriting Association
- Georgia Underwriting Association
- Mississippi Residential Property Insurance Underwriting Association
- Mississippi Windstorm Underwriting Association.

Management stated that "the annual amounts were not significant to its operations as a whole..."

#### Reinsurance Ceded

The Company had one agreement with three participating reinsurers: Platinum Underwriters, Odyssey Reinsurance Group, and Endurance Reinsurance Corporation of America. The agreement was effective January 1, 2004, and in effect at December 31, 2004.

ALA. CODE § 27-2A-2 (1975) states, in part, that all insurers domiciled in Alabama are to file a report with the Alabama Commissioner of Insurance disclosing all material changes that are made to the Company's ceded reinsurance agreements within 15 days after the end of the calendar month in which any of the changes occurred. The Company replaced two of their primary reinsurance programs as of December 31, 2003, and did not provide notice of this change to the Commissioner. The Senior Vice President of Accounting stated that the Company did not feel that this was a material change that requires notification under this Code section because the level of coverage did not change, only the participating reinsurers changed. After the Company filed its 2004 Annual Statement, the Alabama Department of Insurance (ALDOI) requested an update of the changes that had been made to the reinsurance program. This information was sent to the ALDOI on March 30, 2005.

ALA. CODE § 27-5A-4 (1975) states that the Company and the reinsurance intermediary-broker must maintain a written contract. This contract must contain, at minimum, the following provisions:

(1) The insurer may terminate the reinsurance intermediary-broker's authority at any time.

(2) The reinsurance intermediary-broker shall render accounts to the insurer accurately detailing all material transactions, including information necessary to support all commissions, charges, and other fees received by, or owing, to the reinsurance intermediary-broker, and remit all funds due to the insurer within 30 days of receipt.

- (3) All funds collected for the insurer's account shall be held by the reinsurance intermediary-broker in a fiduciary capacity in a bank which is a qualified U.S. financial institution as defined herein.
- (4) The reinsurance intermediary-broker shall comply with ALA. CODE § 27-5A-5 (1975).
- (5) The reinsurance intermediary-broker shall comply with the written standards established by the insurer for the cession or retrocession of all risks.
- (6) The reinsurance intermediary-broker shall disclose to the insurer any relationship with any reinsurer to which business will be ceded or retroceded.

The Company maintained a contract with Preferred Reinsurance Intermediaries, Inc., that included all required contract provisions for 2001, 2002 and 2005. However, no contract was maintained for 2003 and 2004. ALA. CODE § 27-5A-13 (1975) states that: "No insurer or reinsurer may continue to utilize the services of a reinsurance intermediary on or after May 17, 1993, unless utilization is in compliance with this chapter."

#### ACCOUNTS AND RECORDS

The Company's principal accounting records are maintained primarily by computer with certain subsidiary records maintained manually. Other subsidiary records are maintained by Mutual Savings Life Insurance Company's data processing department, which performs many of the record keeping functions for the Company under the previously discussed management and services agreement. Generally, the Company's records were adequate to reflect the Company's transactions during the examination period and its financial condition as of December 31, 2004.

The Company was audited annually by the independent certified public accounting (CPA) firm of Deloitte and Touch, LLP, Birmingham, Alabama, which conducted all of the Company's audits during the period under examination. The audit workpapers of the opining CPA firm were made available to the examiners and were used where deemed appropriate.

The Company's reserve calculations were certified, as of December 31, 2004, by Charles C. Emma, FCAS, MAAA, of Pinnacle Actuarial Resources, Inc., Geneva, Illinois.

In general, the accounting records appeared to reflect the operations during the period under review and the condition of the Company at the date of examination, unless otherwise commented upon under appropriate captions elsewhere in this report.

The Company records indicated that there is no formal control that ensures that the underlying causes of operational failures are identified and addressed. COMPANY OPERATIONS/MANAGEMENT Standard 2, of the NAIC's <u>Market Conduct</u>

Examiners Handbook requires that the Company has appropriate controls, safeguards and procedures for protecting the integrity of computer information.

Company management stated that "a failure log for hardware and program application job failures is maintained" and provided a sample copy of its Hardware Service log. These logs have not been maintained in their entirety or for any specific amount of time. ALA. CODE § 27-27-29(a) (1975), requires the Company to maintain complete and accurate documentation of its transactions, and Alabama Department of Insurance Regulation No. 118, requires records to be maintained at least five years.

The following Information Systems deficiencies were noted during the review of the Information Systems Questionnaire.

#### Management Control

As of year-end 2004, the Company has no formal strategic plan for the business and information systems. Management stated that "there have been significant changes in various aspects of the business and information systems area including computer hardware, software, memory, and applications. These changes do not occur without planning and constant assessment of future needs. What we don't do a good job of is formalizing and documenting the various meetings and planning sessions that do occur and the thought process that are involved in this constant assessment."

#### **Operations**

A review of the Company's operations indicated the following:

- There is no control that ensures that the underlying causes of operational failures are identified and addressed. As noted previously, the failure log is maintained but not for an extended amount of time. Management indicated that henceforth, the "log will be maintained for a period of 5 years as recommended…"
- There is no control that ensures the effective administration of databases. Management stated that "data file changes are documented as application programs are changed" and "there are back up procedures for data files and in certain instances these have been retrieved and used to restore information. Technically speaking MSLIC has no true relational databases. What MSLIC has are data files that can be processed randomly or sequentially."
- IS management does not provide a periodic maintenance schedule for changes to computer systems and infrastructure as well as a mechanism by which the ramifications of these changes can be considered by all impacted groups. According

to Management, "MSLIC does not maintain a formalized documented maintenance schedule because the mainframe computer is maintained in real time." Apparently, IBM monitors the process, and if a problem is detected, they call or provide assistance to address the issue; consequently, the Company states that "a formal documented maintenance system is not necessary; however, we could do a better job of documenting when major changes are made and maintain this documentation for a longer period of time."

• System patches are not monitored to ensure that all systems are updated in a timely manner. Management indicated that "system updates are infrequent but are documented and communicated to the users it impacts. In many instances, these type changes are transparent to the users but may be visible in areas such as response time. We could improve on documenting the few times this does occur and document if certain updates provided by IBM do not affect our process and are not implemented and why."

#### Documentation

The Company does not prepare formalized documentation of its systems program definitions, a high level systems flow chart, narratives, program file definitions or program flow charts for every application.

# Logical and Physical Security

A review of the Company's logical and physical security indicated the following:

- The Company does not review and resolve reports of security violations. Management stated that "While it is true MSLIC does not have a report that lists security violations, it is because we are not aware of any violations that have occurred. Access to CICS and other critical systems requires passwords. If someone tries to access with an invalid password, there is not a report that shows this." When repeated access is denied, "IS gets involved, determines what the problem is and provides a resolution."
- The Company does not have sign-out procedures for computer equipment that is removed from the Company's offices. Management indicated that a sign-out process was not necessary.
- The Company's equipment does not have asset management tags affixed and therefore, is not recorded in an asset management system. Management stated that "Computer equipment sent to the district offices is tagged. Because the net book value is not significant and the low volume of activity in this area, management feels

that a sophisticated asset management inventory system, although it may be helpful, is not necessary."

- The Company does not have formal monitoring procedures and systems to detect unauthorized access attempts from either outside or inside the Company.
   Documentation of unsuccessful unauthorized access attempts is not maintained.
- The Company does not have formal, documented emergency response procedures to follow if a computer security incident occurs.

The Assistant Vice President of Application Systems indicated that use of sensitive software utilities is restricted to authorized personnel. There is no formal log or record of use of these types of software. Three follow-up requests were sent for a list of sensitive software and people authorized to use it. The Vice President of Information Technology ultimately responded that initially, the question was answered incorrectly and that the Company does not have a formal control of special software. A listing of "sensitive software utilities" was ultimately provided.

#### IS Strategy

The Company's IS plans and strategies have not been reduced to writing or including in a manual. Also, there is no formal Table of Contents or Executive Overview of the strategic plan for the business and information systems. Management stated that "meetings and planning sessions do occur and the thought processes that are involved in managing IS are constantly undergoing re-assessment."

#### Contingency Planning

A review of the Company's contingency planning indicated the following:

- The Company has a business contingency plan; however, it is not based on a business impact analysis and has not been tested. Also, the plan does not address all significant business activities including financial functions, telecommunication services, data processing and network services.
- Although the Company maintains that there is an informal/verbal agreement for use of an alternate site and computer hardware to restore data processing operations after a disaster occurs, no written agreement of the arrangements was available for review.
- The Company's business contingency plan does not contain a list of the supplies that would be needed in the event of a disaster, together with names and phone numbers of the suppliers.
- User departments have not developed adequate manual processing procedures for use until the electronic data processing function can be restored.

• The Company has an up to date disaster recovery plan in effect; nevertheless, the plan has not been completely tested.

COMPANY OPERATIONS/MANAGEMENT Standard 2, of the NAIC's <u>Market Conduct Examiners Handbook</u> requires that the Company has appropriate controls, safeguards and procedures for protecting the integrity of computer information

#### FINANCIAL STATEMENT INDEX

The Financial Statements included in this report were prepared on the basis of the Company's records and the valuations and determinations made during the course of the examination for the year 2004. Amounts shown in the comparative statements for the year 2000, 2001, 2002, and 2003 were compiled from Company copies of filed Annual Statements. The statements are presented in the following order:

	Page
Statement of Assets, Liabilities, Surplus and Other Funds	26
Summary of Operations	27
Capital and Surplus Account	27

# MUTUAL SAVINGS FIRE INSURANCE COMPANY STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS For the Year Ended December 31, 2004

ASSETS		Assets_	N	Ionadmitted Assets	No	et Admitted Assets
Bonds (Note 1)	\$	2,738,704	\$	-	\$	2,738,704
Cash, cash equivalents and						
short-term investments (Note 2)		(263,500)				(263,500)
Subtotal, cash and invested assets	\$	2,475,204	\$	-	\$	2,475,204
Investment income due and accrued		45,300				45,300
Premium considerations:				·		
Uncollected premiums and agents' balances in						455 500
the course of collection (Note 7)		157,520		_		157,520
Reinsurance: Amounts recoverable from reinsurers		102,914		-		102,914
Current federal and foreign income tax recoverable						112 (70
and interest thereon (Note 3)		113,672		-		113,672
Net deferred tax asset		533,901		339,995		193,906
Guaranty funds receivable or on deposit		15,540		-		15,540
Receivable from parent, subsidiaries		6.074				6,274
and affiliates (Note 4)		6,274		29 700		0,274
Premium tax paid in advance		28,709		28,709		56,283
Equities and deposits in pools and associations		56,283	_	260 704	<del></del>	
TOTAL	<u>\$</u>	3,535,317	\$	368,704	\$	3,166,613
LIABILITIES						<u>2004</u>
Losses (Note 5)		•			\$	849,613
Loss Adjustment Expense (Note 6)						131,690
Other expenses (excluding taxes, licenses and fees)						28,788
Taxes, licenses and fees due or accrued (excluding fee	leral i	ncome tax)				5,888
Unearned premiums (Note 7)						235,736
Advance premiums (Note 7)						112,967
Ceded reinsurance premiums payable (net of ceding of						6,330
Amounts withheld or retained by company for accou	nt of	others				3,071
TOTAL LIABILITIES					\$	1,374,083
CAPITAL AND SURPLUS						
Common capital stock					\$	1,500,000
Unassigned funds (surplus) (Note 8)					_	292,530
Surplus as regards policyholders					\$	1,792,530
TOTAL LIABILITIES, CAPITAL AND SURPLUS					\$	3,166,613

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTREGRAL PART THEREOF.

# MUTUAL SAVINGS FIRE INSURANCE COMPANY SUMMARY OF OPERATIONS

# For the Years Ended December 31, 2004, 2003, 2002 and 2001

		2004		2003		2002		2001
UNDERWRITING INCOME	•	4.405.000	<b>⊕</b>	4 004 742	æ	4 204 100	<b>C</b>	4,160,546
Premiums earned	\$	4,135,392	\$	4,281,613	\$	4,294,188	\$	4,100,540
DEDUCTIONS								
Losses incurred	\$	3,853,397	\$	2,429,824	\$	1,945,742	\$	2,007,056
Loss expenses incurred		447,353		175,075		153,904		140,917
Other underwriting expenses incurred		1,833,824		1,751,396		1,790,263		1,742,556
Primesco Management Fee	_	63,288		38,949	_			
Total underwriting deductions	\$	6,197,862	<u>\$</u>	4,395,244	\$	3,889,909	\$	3,890,529
Net underwriting gain or (loss)	\$	(2,062,470)	\$	(113,631)	\$	404,279	\$	270,017
INVESTMENT INCOME								
Net investment income earned	\$	140,346	\$	147,723	\$	157,677	\$	234,006
Net realized capital gains (losses)		44,310		(33,995)		(351,583)		(79,687)
Net investment gain or (loss)	\$	184,656	\$	113,728	\$	(193,906)	\$	154,319
OTHER INCOME								
Miscellaneous income	\$	26	\$	903	\$	67	\$	2
Total other income	<del>"</del> \$	26	\$	903	\$	67	\$	2
	47_		71		<u></u>			
Net income before dividends to policyholders and before federal and foreign income taxes	•	(1,877,788)	\$	1,000	\$	210,440	\$	424,338
	₩	(113,672)	\$	(44,616)	<u>*</u>	132,911	\$	186,997
Federal and foreign income taxes incurred	<u>\$</u>				<del>*</del> \$	77,529	<del>*</del> \$	237,341
Net income	<u> </u>	(1,764,116)	\$_	45,616	₽_	11,525	₩	237,311
CAPITAL AND SURPLUS ACCOUNT								
Surplus as regards policyholders,					45		<i>a</i> >	2.047.445
December 31 prior year	\$	3,391,459	\$_	3,457,189	\$	3,388,280	<u>\$</u>	3,017,145
GAINS AND (LOSSES) IN SURPLUS								
Net Income		(1,764,116)		45,616		77,529		237,341
Change in net unrealized capital gains or (losses)		-		44,000		(4,000)		(40,000)
Change in net deferred income tax		460,091		(51,886)		(23,336)		43,248
Change in nonadmitted assets		(294,904)		(3,460)		356,716		(76,701)
Cummulative effect of changes in accounting principles								607,247
Dividends to stockholders	_		_	(100,000)	_	(338,000)		(400,000)
Change in surplus as regards policyholders for the year	\$	(1,598,929)	\$	(65,730)	\$	68,909	\$	371,135
Surplus as regards policyholders,								
December 31 current year	\$	1,792,530	\$	3,391,459	<u>\$</u>	3,457,189	\$	3,388,280

THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTREGRAL PART THEREOF.

#### NOTES TO FINANCIAL STATEMENTS

<u>Note 1 – Bonds</u> \$2,738,704

The captioned amount is the same as reported by the Company in its 2004 Annual Statement. The following exceptions were noted during the review of the Company's bond controls:

Control procedures were performed to ascertain that quoted market prices for investment transactions are compared periodically to purchase/sale prices by persons independent of those executing and approving transactions. Management does not purchase securities directly from a broker or a dealer. All purchases and sales are done by investment advisors. Quotes are not independently verified by the Company. A Director, who is also a member of the informal investment committee, makes selective reviews of trade quotes and obtains independent quotes from other brokers to determine if the fair value is being obtained by the advisors. This review is not performed on a regular basis, and no documentation was provided to support that a review occurs.

The Company does not have sufficient controls in place to prevent unauthorized personnel from engaging in derivative transactions. The Company's procedures to prevent unauthorized personnel from engaging in derivative transactions are the same as preventing unauthorized personnel from any unauthorized investments as disclosed in the "Investment Objectives, Policies, and Guidelines." However, there are no controls in place to make certain that authorized personnel do not engage in transactions that are not authorized. The Company should limit the authority of individuals to act through the investment brokers that the Company utilizes, and the brokerage agreement should specify the type of transactions that are authorized.

# Note 2 – Cash, cash equivalents and short-term investments \$(263,500)

The captioned amount is the same as reported by the Company in its 2004 Annual Statement. The following exception was noted during the review of the Company's cash controls:

The Company does not have adequate procedures to account and safeguard cash and assets that are not deposited when received. The Company has an employee that has access to cash and prepares the bank reconciliation.

# Note 3 – Current federal and foreign income taxes recoverable and interest thereon

\$113,672

The captioned amount is the same as reported by the Company in its 2004 Annual Statement.

SSAP No. 10, paragraph 23, of the NAIC's Accounting Practices and Procedures Manual, states that if a reporting entity's federal income tax return is consolidated with those of any other entity or entities, the following shall be disclosed: (a) a list of the names of the entities with whom the reporting entity's federal income tax return is consolidated for the current year; and (b) the substance of the written agreement, approved by the reporting entity's Board of Directors, which sets forth the manner in which the total combined federal income tax for all entities is allocated to each entity which is a party to the consolidation. Additionally, the disclosure shall include the manner in which the entity has an enforceable right to recoup federal income taxes in the event of future net losses which it may incur or to recoup its net losses carried forward to offset to future income subject to federal income taxes.

The 2004 Annual Statement's *Notes to Financial Statements* did not disclose that the Company's tax allocation agreement was approved by the Board of Directors.

# Note 4 – Receivables from parent, subsidiaries and affiliates Payable to parent, subsidiaries and affiliates

<u>\$6,274</u>

<u>\$ -0-</u>

The above captioned amount for Receivable from parent, subsidiaries and affiliates is the same as reported in the 2004 Annual Statement but \$21,338 less than the amount determined by this examination.

The above captioned amount for *Payable from parent, subsidiaries and affiliates* is the same as reported in the 2004 Annual Statement but \$21,338 less than the amount determined by this examination.

The Company has a *Management Services Agreement* with its parent company, Mutual Savings Life Insurance Company (MSLIC), which was discussed previously in this report in the "Transactions and Agreements with Affiliates" section. It was determined that MSLIC collected \$27,611.39 in fire premium on behalf of the Company during the last week of December 2004, which was owed to the Company at December 31, 2004. It was also determined that the Company owed MSLIC for administrative fees in the amount of \$3,010 and fire commissions in the amount of \$18,238, which totals \$21,248. The Company netted the receivable and the payable, which was not in compliance with *SSAP No. 64*, paragraph 2, of the NAIC's <u>Accounting Practices and Procedures</u>

Manual. This SSAP states that "a valid right of setoff exists only when all of the following conditions are met:

a.) Each of the two parties owes the other determinable amounts. An amount shall be considered determinable for purposes of this provision when it is reliably estimable by both parties to the agreement;

b.) The reporting party has the right to setoff the amount owed with the amount

owed by the other party;

c.) The reporting party intends to setoff; and

d.) The right of setoff is enforceable."

In addition, SSAP No. 64, paragraph 5, of the NAIC's <u>Accounting Practices and Procedures Manual states</u> that "Amounts due to or from affiliates shall be offset and reported net only when the provisions of paragraph 2 above are met."

The examiners reviewed the management agreement and determined that there was no provision regarding the right to offset. Therefore, the Company should not have offset the receivable from parent and the payable to parent because all of the conditions were not met. Due to immateriality, no changes were made to the financial statements.

Note 5 – Losses \$849,613

The captioned amount is \$127,000 more than the \$722,613 amount reported by the Company in its 2004 Annual Statement.

Examination reserves estimates, based on actual development through September 30, 2005, indicate approximately \$193,000 of adverse development on 2004 Annual Statement combined loss and loss adjustment expense (LAE) reserves. Of the total \$193,000 indicated adjustment, \$127,000 was attributed to loss reserves, while the remaining \$66,000 represents an adjustment to LAE reserves, further discussed below in Note 5. The difference was largely due to Hurricane Ivan claims development. Normally, for a property company, loss and loss adjustment expense (LAE) reserves are relatively easy to predict. In light of this, the indicated difference was relatively large.

Given the actual development through September 2005, the examination reserves were not subject to significant uncertainty. The reasonable range around the examination reserve is probably only plus/minus \$20,000, since almost all 2004 and prior claims were closed by September 30, 2005.

The Alabama Department of Insurance's actuarial review did not encounter any systemic problems with the reserving methodology or process. In addition, the Company has a mandatory annual review by a qualified actuary, which the actuarial examiners found to be

appropriate. In this instance, the adverse development was due to random fluctuation related to Hurricane Ivan unexpected development, which in the actuarial examiner's judgment, was not a result of oversight or error.

A review of the Company's 2004 *Underwriting and Investment Exhibit*, Part 2A, indicated that the Company did not properly classify its Hurricane Ivan claims, which is not in compliance with the NAIC's <u>Annual Statement Instructions</u> and *SSAP No. 55*, paragraph 5, of the NAIC's <u>Accounting Practices and Procedures Manual</u>. It was determined that the Company had reported Ivan claims; however, the Company included all of the Ivan claims in the incurred but not reported column 5. The Company should have reported \$9,358.62 of the Ivan amount in the reported losses column 1. Consequently, the total reported amount for all losses should have been \$117,821, and the total incurred but not reported amount should have been \$604,792, which totals \$722,613, the same amount reported for *Losses* in the 2004 Annual Statement. Company management was aware of the Hurricane Ivan related issues by April 2005, and acknowledged that its losses and LAE reserves had, therefore, been understated at the examination date. It was noted that adjustment was made in the Audited Statutory Basis Financial Statements filed with the Alabama Department of Insurance on June 1, 2005.

Losses related to Hurricane Ivan exceeded the Company's 2004 catastrophe reinsurance program. It is the actuarial examiner's understanding that the Company's reinsurers have recommended that the Company purchase higher limits of catastrophe coverage. The actuarial examiner recommends that the Company continue to maintain catastrophe coverage for at least a one-in-100-year event.

A sample of 45 claims paid in the first quarter of 2005 was selected in order to trace the individual determinants on the claims paid dataset to the claim documentation. The report dates for five of the 45 claims sampled were different than the report dates on the claim documentation for five policies. Therefore, the Company is not in compliance with ALA. CODE § 27-27-29(a) (1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

#### Note 6 - Loss adjustment expenses

\$131,690

The captioned amount is \$66,000 more than reported by the Company's in its 2004 Annual Statement.

Loss adjustment expense (LAE) reserves were not correctly allocated to defense and cost containment (DCC) and adjusting and other (A&O) categories with the Annual Statement. Neither the loss reserves nor the LAE reserves were correctly allocated to the case and bulk and incurred-but-not-reported (IBNR) portions in the 2004 Annual Statement. The Company booked all LAE reserves as DCC case reserves in Schedule P, which is not in compliance with the NAIC's Annual Statement Instructions and SSAP No. 55, paragraph 5, of the NAIC's Accounting Practices and Procedures Manual. The Company does not track case reserves for DCC; therefore, none of the LAE reserves should have been attributed to DCC case reserves within Schedule P. However, the Company did not book true case loss reserves either. The amount booked for case loss reserves was actually the amount paid in the first two weeks of January 2005, on claims that were reported at year-end 2004. The Company's procedure for DCC was roughly equivalent, considering that most of the LAE reserves are attributable to Hurricane Ivan claims, which were assumed to be reported by year-end 2004. The booked LAE reserve amount should have been allocated to DCC case reserves, DCC bulk and IBNR reserves, and A&O reserves.

Note 7 – <u>Unearned premiums</u>	<u>\$235,736</u>
Uncollected premiums and agents' balances	\$157,520
in course of collection	
Advance Premiums	<u>\$112,967</u>

The captioned amount for *Unearned premiums* is \$89,975 less than the \$325,711 amount reported in the Company's 2004 Annual Statement.

The captioned amount for *Uncollected premiums and agents' balances in the course of collection* is \$22,992 greater than the \$134,528 amount reported in the Company's 2004 Annual Statement.

The captioned amount for *Advance premiums* is \$112,967 greater than the \$0 amount reported in the Company's 2004 Annual Statement.

It was determined that the Company inappropriately included its 2004 advance premium liability and its 2004 first year uncollected premiums asset in the unearned premium liability line item. See below for the amounts included in that line item.

1st Year Uncollected Premiums	\$ 22,992
Advance Premiums	112,966
Unearned Premiums	<u> 189,753</u>
Total unearned premiums line item	\$ <u>325,711</u>

The Company was not in compliance with the NAIC's <u>Annual Statement Instructions</u> as its premiums were not properly included in the correct line items. As the result of proper classification by line, the Company's 2004 uncollected premiums increased by \$22,992, advance premiums increased by \$112,966, and unearned premiums decreased by \$89,975. The \$325,711 total reported by the Company as *Unearned premiums* did not change as a result of the reclassifications.

When this information was brought to the Company's attention, management acknowledged the error and corrected the classifications in the 2<sup>nd</sup> Quarterly Statement filed in 2005.

# Note 8 - Unassigned funds (surplus)

\$292,530

Unassigned funds (surplus), as determined by this examination, was \$193,000 less than the \$485,530 amount reported by the Company in its 2004 Annual Statement.

The following schedule presents a reconciliation of the unassigned funds per the Company's filed statement to that developed by this examination.

Unassigned funds (surplus) per Company		\$ 485,530
<ul> <li>Examination increase/(decrease) to assets:</li> <li>Note 7 - Uncollected premiums and agents balances in course of collection</li> <li>Total increase/(decrease) to assets</li> </ul>	\$ 22,992 \$ 22,9	992
<ul> <li>Examination (increase)/decrease to liabilities:</li> <li>Note 5 - Losses</li> <li>Note 6 - Loss adjustment expenses</li> <li>Note 7 - Unearned premiums</li> <li>Note 7 - Advance premiums</li> <li>Total (increase)/decrease to liabilities</li> </ul>	(127,000) (66,000) 89,975 (112,967) (215,	992)
Net Increase/Decrease		(193,000)
Unassigned funds (surplus) per Examination		<u>\$ 292,530</u>

# CONTINGENT LIABILITIES AND PENDING LITIGATION

The review of contingent liabilities and pending litigation included an inspection of representations made by Company management; a review of the attorney confirmations; and a general review of the Company's records and files conducted during the examination. This review did not disclose any items that would have a material effect on the Company's financial condition in the event of an adverse outcome.

# COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

A review was conducted during the current examination with regard to the Company's compliance with the recommendations made in the previous examination report. This review indicated that the Company had satisfactorily complied with the prior recommendations, with the exceptions of certain items detailed below.

Corporate Records – The previous examination determined that the Board of Directors did not approve the investment advisory agreement with two firms authorized to engage in investments on behalf of the Company and was, therefore, not in compliance with ALA. CODE § 27-41-5 (1975), which requires that all investments be authorized, approved or ratified by the Board of Directors and that the Board's actions be recorded on a regular basis.

It was noted that corporate minutes during the current examination period did not reflect approval of investments or any investment advisory agreement. The two agreements mentioned in the previous examination report were with Conseco Capital Management and Sovereign Advisors. The agreement with Conseco was terminated on August 29, 2002. An Investment Advisory Agreement with Sovereign, dated January 29, 1999, was between Sovereign, Primesco, Inc., and MSLIC and did not include this company. Management indicated that MSFire has always operated under the agreement as if they were a party to it. An Amendment to Investment Advisory Agreement, also dated August 29, 2002, indicated revised terms concerning the agreement between Sovereign, Primesco, MSLIC, and MSFire. No such agreement existed at the examination date. A Company officer stated that after the previous examination, the Company intended to add MSFire to the agreement but "never got around to it." The agreement was not approved by the Alabama Department of Insurance. All management agreements, service contracts and cost sharing arrangements with affiliates or persons within the holding company system must not be entered into unless the Company has notified the Alabama Insurance Commissioner of its intention to do so in accordance with ALA. CODE § 27-29-5(b) (1975).

Subsequent to the examination period, on February 23, 2006, the *Investment Advisory Agreement* with Sovereign Advisors was amended to specifically include the Company as a party to the agreement.

Based on the review of corporate records at the examination date, and discussions with Company management, MSFire's Board of Directors did not approve investments as required by ALA. CODE § 27-41-5 (1975) until December 2005; consequently, the Company did not comply with the previous examination recommendation during the examination period.

Holding Company and Affiliate Matters – Under this caption, the previous examination report stated that the Company could not provide a detailed listing of items comprising commissions and recommended that the Company keep complete and accurate records of its commission expenditures. As of December 31, 2004, the Company had not complied with this recommendation. Management stated that the information "is impossible to give. MSFire does not pay its agents in this manner and the agent's contract is not structured in a manner to provide the requested commission paid by policy by agent information. Due to the nature of our business, we cannot comply with this request."

Management and Service Agreements – The previous examination report noted that the Company was not operating under the terms of its *Management Services Agreement*, dated October 19, 1999, with Primesco, Inc., and MSLIC. The agreement provided that Primesco may waive any part or all of the fees payable to it under this agreement. Primesco must make such waiver in writing. It was noted during this examination that Primesco was waiving part of the fees it was charging to MSLIC and the Company; however, there was no written waiver.

Fidelity Bonds – The previous examination recommended that the Company obtain at least the minimum amount of fidelity coverage for protection against fraudulent acts of the Company's employees in accordance with the NAIC's <u>Financial Condition</u> <u>Examiners Handbook</u>. While the Company maintained limited coverage for employee dishonesty, forgery and/or alteration, the minimum amount suggested by the aforementioned NAIC publication was not met; therefore, the Company did not comply with the prior recommendation in its entirety.

# COMMENTS AND RECOMMENDATIONS

The following summary presents the comments and recommendations that were made in the current Report of Examination:

## Corporate Records – Page 6

It is recommended that the *Investment Advisory Agreement* be revised to include the Company, if the Company continues to be a party to its provisions.

It is recommended that all management agreements, service contracts and cost sharing arrangements with affiliates or persons within the holding company system not be entered into unless the Company has notified the Alabama Insurance Commissioner of its intention to do so in accordance with ALA. CODE § 27-29-5(b) (1975), which requires that "...transactions involving a domestic insurer...may not be entered into unless the insurer has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto..."

It is recommended that the Company approve its investments as required by ALA. CODE § 27-41-5 (1975), which specifies that all investments be authorized, approved, or ratified by the Board of Directors and that the Board's actions be recorded on a regular basis. These recommendations were also made in the previous examination.

# Management and Service Agreements - Page 8

It is again recommended that the Company operate in accordance of the terms of its agreement with Primesco and require written notice regarding waivers.

# Fidelity Bonds and Other Insurance - Page 10

It is recommended that the Company make a good faith attempt annually to obtain at least the minimum amount of fidelity coverage for protection against dishonest or fraudulent acts of the Company's employees in accordance with the guidelines established in the NAIC's <u>Financial Condition Examiners Handbook</u>. This recommendation has also been made in the previous two examination reports.

# Employee and Agents' Welfare - Page 11

It is recommended that the Company require all current employees and agents to sign an affidavit concerning the Violent Crime and Law Enforcement Act of 1994 on at least an annual basis in order to ensure compliance with US Code, Title 18, Section 1033 (e)(1)(A) and Ala. Admin. Code 482-1-121 (2003), Procedures Governing Persons

Subject to 18 U.S. Code § 1033, which prohibit certain persons from participating in the business of insurance.

# Marketing and Sales - Page 13

It is recommended that the Company develop a policy to maintain, save, store or archive any electronic-mail that is broadcast to the sales force in accordance with ALA. CODE § 27-27-29(a) (1975), which requires the Company to maintain "complete records of its assets, transactions and affairs..."

# **Underwriting and Rating** – Page 15

It is recommended that the Company provide all applicants with a reason for declination or advise such person that upon written request, he or she may receive the specific reason or reasons in writing.

It is recommended that the Company maintain complete and accurate files by recording the reason for cancellation or non-renewal in accordance with ALA. CODE § 27-27-29(a) (1975), which requires the Company to keep "complete records of its assets, transactions and affairs..."

# Complaint Handling Practices - Page 16

It is recommended that the Company maintain complete records of its complaints in the required format in accordance with ALA. CODE § 27-27-29(a) (1975) and COMPLAINT HANDLING Standard 1, of the NAIC's <u>Market Conduct Examiners Handbook</u>.

It is recommended that the Company utilize one standard set of procedures for the handling and analysis of complaints, and develop a method of distribution of and obtaining and recording responses to complaints. COMPLAINT HANDLING Standard 2, of the NAIC's Market Conduct Examiners Handbook, requires the Company to have adequate complaint handling procedures in place and communicate such procedures to policyholders.

It is recommended that the Company take adequate steps to finalize and dispose of complaints in accordance with applicable statues, rules and regulations, and contract language, as required by COMPLAINT HANDLING Standard 3, of the NAIC's Market Conduct Examiners Handbook.

## Policyholder Service – Page 17

It is recommended that the Company keep complete and accurate records of the insured-requested cancellations and correspondence in accordance with ALA. CODE § 27-27-29(a) (1975). POLICYHOLDER SERVICE Standard 2, of the NAIC's Market Conduct Examiners Handbook requires that "Policy issuance and insured requested cancellations are timely." POLICYHOLDER SERVICE Standard 3, requires that "All correspondence directed to the company is answered in a timely and responsive manner by the appropriate department."

## Claims Handling Practices:

# Reservation of Rights/Excess of Loss Letters - Page 18

It is recommended that the Company send a reservation of rights letter to the insured when there is reason to question coverage, and an excess of loss letter when it is apparent that the amount of loss will exceed policy limits, in accordance with guidelines established by CLAIMS Standard 7, of the NAIC's Market Conduct Examiners Handbook.

## Subrogated Claims - Page 18

It is recommended that the Company maintain complete and accurate records, including subrogated claims, in accordance with ALA. CODE § 27-27-29(a) (1975), which requires that: "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds of insurance transacted."

# Denied and Closed-without-payment claims - Page 18

It is recommended that the Company keep and maintain records of the claims that were denied and closed-without-payment in accordance with ALA. CODE § 27-27-29(a) (1975).

In accordance with ALA. ADMIN. CODE 482-1-125-.04(a) (2003), it is recommended that the Company "maintain claim files that are accessible and retrievable for examination...for all claims closed without payment. This data must be available for all open and closed files for the current year and the five (5) preceding years, in order to permit reconstruction of the insurer's activities relative to each claim."

## Reinsurance Ceded - Page 20

It is recommended that the Company file a report with the Alabama Commissioner of Insurance disclosing all material changes that are made to the Company's ceded reinsurance agreements within 15 days after the end of the calendar month in which any of the changes occurred in accordance with ALA. CODE § 27-2A-2 (1975).

It is recommended that the Company maintain a valid written contract with its reinsurance intermediary-broker that contains all contract provisions required by ALA. CODE § 27-5A-4 (1975).

It is recommended that the Company comply with ALA. CODE § 27-5A-13 (1975), which states that: "No insurer or reinsurer may continue to utilize the services of a reinsurance intermediary on or after May 17, 1993, unless utilization is in compliance with this chapter."

### Accounts and Records - Page 21

It is recommended that the Company test its business contingency plan.

It is recommended that the Company maintain complete and accurate records in accordance with ALA. CODE § 27-27-29(a) (1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

It is recommended that the Company maintain complete records of its Hardware Service logs in order to evidence that the underlying causes of operational failures are identified and addressed. Ala. Code § 27-27-29(a) (1975), requires the Company to maintain complete and accurate documentation of its transactions, and Alabama Department of Insurance Regulation No. 118, requires records to be maintained at least five years.

The following recommendations are made regarding the Company's Information Systems:

# <u>Management Control</u> – Page 22

It is recommended that the Company develop and maintain a formal, written strategic plan for the business and information systems.

## Operations – Page 22

#### It is recommended that:

- the Company establish controls to ensure that the underlying causes of operational failures are identified and addressed;
- the Company establish controls to ensure the effective administration of databases;
- management provide a periodic maintenance schedule for changes to computer systems and infrastructure as well as a mechanism by which the ramifications of these changes can be considered by all impacted groups; and
- system patches be monitored to ensure that all systems are updated in a timely manner.

## Documentation - Page 23

It is recommended that the Company prepare systems program definitions, a high level systems flow chart, narratives, program file definitions or program flow charts for every application.

# Logical and Physical Security - Page 23

#### It is recommended that:

- management review and resolve reports of security violations;
- sign-out procedures be established for computer equipment that is removed from the Company's offices;
- all equipment have asset management tags affixed;
- all equipment be recorded in an asset management system;
- the Company have formal monitoring procedures and systems to detect unauthorized access attempts from either outside or inside the Company;
- the Company establish formal emergency response procedures to follow if a computer security incident occurs; and
- the Company establish, document and operate under formal controls to restrict access to sensitive software utilities.

## IS Strategy - Page 24

It is recommended that the Company develop and maintain a formal, written strategic plan for the business and information systems.

## Contingency Planning - Page 24

It is recommended that the Company:

- base its business contingency plan on a business impact analysis;
- test its business contingency plan;
- revise its business contingency plan to address all significant business activities including financial functions, telecommunication services, data processing and network services;
- consider maintaining an agreement for the use of an alternate site and computer hardware to restore data processing operations after a disaster occurs;
- revise its business contingency plan to contain a list of supplies that would be needed in the event of a disaster, together with names and phone numbers of the suppliers;
- require user departments develop adequate manual processing procedures for use until the electronic data processing function can be restored; and
- test its disaster recovery plan.

COMPANY OPERATIONS/MANAGEMENT Standard 2, of the NAIC's <u>Market Conduct Examiners Handbook</u> requires that: "The Company has appropriate controls, safeguards and procedures for protecting the integrity of computer information."

## **Bonds** – Page 28

It is recommended that an individual independent of executing and approving transactions compare purchase/sale prices to quoted market prices on investment transaction dates.

It is recommended that the Company establish controls by specifying in the brokerage agreements what types of transactions can be entered into in order to prevent personnel from engaging in transactions that are not authorized.

## Cash and short-term investments – Page 28

It is recommended that the Company create adequate safeguards for cash and assets that are not deposited when received.

# Current federal and foreign income tax recoverable and interest thereon - Page 29

It is recommended that the Board of Directors approve its tax allocation agreement in accordance with SSAP No. 10, paragraph 23, of the NAIC's Accounting Practices and Procedures Manual.

It is also recommended that the Company disclose within the Annual Statement's *Notes to Financial Statements* that the Board of Directors approved the written tax allocation agreement in accordance with *SSAP No. 10*, paragraph 23, of the NAIC's <u>Accounting Practices and Procedures Manual</u>.

Receivable from parent, subsidiaries and affiliates/Payable to parent subsidiaries and affiliates – Page 29

It is recommended that the Company comply with SSAP No. 64, paragraph 5, of the NAIC's Accounting Practices and Procedures Manual and not offset the amounts due to or from affiliates unless all provisions of SSAP No. 64, paragraph 2, are met.

<u>Losses</u> – Page 30 <u>Loss adjustment expenses</u> – Page 31

It is recommended that the Company correctly report its losses in its *Underwriting and Investment Exhibit*, Part 2A, in accordance with the NAIC's <u>Annual Statement Instructions</u>, and *SSAP No. 55*, paragraph 5, of the NAIC's <u>Accounting Practices and Procedures Manual</u>.

It is recommended that the Company maintain complete and accurate records of its claims in accordance with ALA. CODE § 27-27-29(a) (1975), which states: "Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted."

It is recommended that the Company correctly reflect the allocation of total LAE reserves to defense and cost containment case reserves, defense and cost containment bulk and incurred but not reported reserves, and adjusting and other reserves in *Schedule P* of future Annual Statements in compliance with NAIC's <u>Annual Statement Instructions</u> and *SSAP No. 55*, paragraph 5, and *SSAP No. 70*, of the NAIC's <u>Accounting Practices</u> and <u>Procedures Manual</u>.

It is recommended that the Company continue to maintain catastrophe coverage for at least a one-in-100-year event.

<u>Unearned premiums</u>, <u>Uncollected premiums and agents' balances in the course of collection</u>, and <u>Advance premiums</u> – Page 32

It is recommended that the Company classify its premiums in the proper Annual Statement line in accordance with the NAIC's <u>Annual Statements Instructions</u>.

#### SUBSEQUENT EVENTS

## Hurricane activity

Due to damages suffered in 2005 as a result of Hurricanes Dennis and Katrina, incurred losses increased \$505,400 (25.3%) comparing \$2,504,026 to \$1,998,626 for the nine months of 2005 and 2004, respectively. The nine month period ending September 30, 2005, reflected an underwriting loss of \$758,849, compared to an underwriting loss of \$351,825, for the comparative nine months period of 2004. Third quarter 2005 was affected by Hurricanes Dennis and Katrina, compared to the third quarter 2004, which was affected by Hurricane Ivan. The second quarter 2005 showed an underwriting gain of \$139,206, and management estimated underwriting results for the third quarter 2005 would have been a gain of approximately \$198,000, without the effects of the hurricanes.

## Regulatory action

A decrease in the Company's surplus triggered regulatory action by the Mississippi Department of Insurance (MDOI). Management informed the Alabama Department of Insurance stated that the MDOI had suspended the Company's license to conduct business in that state on March 10, 2005, because its surplus had dropped below the \$600,000 required by Mississippi law. To correct this impairment the Company's parent, Mutual Savings Life Insurance Company (MSLIC), contributed \$200,000 into the Company's surplus account, bringing its surplus to \$685,530. The suspension was lifted on March 15, 2005. To ensure that the Company possessed sufficient surplus to satisfy the requirements of each of the states in which it is licensed, MSLIC contributed an additional \$1 million into the Company's surplus account on March 30, 2005.

## Capital Contributions

During 2005, the Company's parent, Mutual Saving Fire Insurance Company, made the following contributions to the Company:

<u>Date</u>	<u>Amount</u>
March 14, 2005	\$ 200,000
March 20, 2005	\$1,000,000
October 10, 2005	\$ 500,000
December 22, 2005	\$ 700,000

The Company's Senior Vice President of Accounting stated that the first two contributions were to increase capital and surplus levels, which had been reduced due to losses sustained in 2004 as the result of Hurricane Ivan. The third and fourth contributions were to increase capital and surplus levels which had been reduced due to losses sustained in 2005 as the result of Hurricanes Dennis and Katrina. All contributions were appropriately reported to the Alabama Department of Insurance in Form B filings.

#### **CONCLUSION**

Acknowledgement is hereby made of the courteous cooperation extended by all persons representing the Company during the course of the examination.

The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and evaluation of assets and the determination of liabilities.

In addition to the undersigned, Tisha Freeman, Theo Goodin, Felicia McKinzy, Anne Pruett and Lori Wright, Examiners; and Randy Ross, ACAS, MAAA, Consulting Actuarial Examiner; all representing the Alabama Department of Insurance, participated in this examination of *Mutual Savings Fire Insurance Company*.

Respectfully submitted,

Anne L. Ward, AFE

Examiner-in-Charge

State of Alabama

Department of Insurance

March 17, 2006

# EXAMINER'S AFFIDAVIT AS TO STANDARDS AND PROCEDURES **USED IN AN EXAMINATION**

#### STATE OF ALABAMA

#### **COUNTY OF MORGAN**

James L. Hattaway, III, being duly sworn, states, as follows:

- 1. I have authority to represent the State of Alabama in the examination of Mutual Savings Fire Insurance Company, Decatur, Alabama.
- 2. The Alabama Department of Insurance is accredited under the National Association of Insurance Commissioners Financial Regulation Accreditation Standards.
- 3. I have reviewed the examination workpapers and examination report, and the December 31, 2004 examination of Mutual Savings Fire Insurance Company, Decatur, Alabama, was performed in a manner consistent with the standards and procedures required by the Alabama Department of Insurance, and the National Association of Insurance Commissioners.

The affiant says nothing further.

(Notary Public)

James L. Hattaway, III, CFE	
Insurance Examination Supervisor	
State of Alabama, Department of Insurance	
Subscribed and sworn before me by on this 17 <sup>th</sup> day of March, 2006.	James L. Hattaway, III
(SEAL)	
Susan Blackwood	SUSAN C. BLACKWOOD  Notary Public, AL State at Large My Comm. Expires Dec. 06, 2009  My Commission expires

(Date)